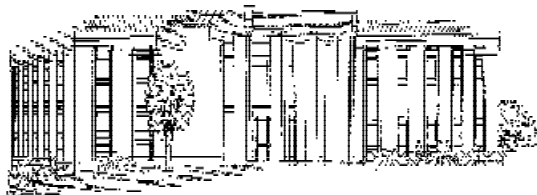


KTRS NEWSLETTER

TEACHERS' RETIREMENT SYSTEM
OF THE STATE OF KENTUCKY

RETIRED MEMBER EDITION
January/February 2004



2004 Legislative Proposals

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During its December 2003 meeting, the KTRS Board of Trustees approved proposals for the 2004 General Session. This proposal is summarized in three areas – I. Change in the Funding Formula for the Medical Insurance Fund; II. Cost of Living Adjustments; and III. Other Measures. These three areas are summarized below:

I. Change in Funding Formula for Medical Insurance Fund

The focus of the legislative proposal for the 2004 General Session concerns long-term funding of the KTRS medical insurance program. This program was established in 1964 by the General Assembly on a "pay-as-you-go" basis under which the contributions of active members help fund the medical insurance program for retired members. The basic funding for this benefit has been the same since 1986 - ¾% contributed from members and matched by the state. With the ratio of retirees to active members increasing coupled with double-digit medical inflation, this level of funding alone is no longer sufficient to fund the benefit.

The basic funding has been augmented since 1998-99 with supplemental funding when the level of funding for retirement benefits improved to the point that the actuary recommended that a portion of contributions to the retirement fund be used to alleviate the shortfalls of the medical insurance fund. As a result of the subsequent economic downturn, the actuary has advised the System that those funds will be needed to continue the soundness of the retirement plan. The retirement plan is funded in advance of

retirement on an actuarially sound basis as compared to the pay-as-you-go funding for the medical plan.

Since 1998, this supplemental funding has enabled the retirement system to accumulate reserves in the medical insurance fund, however, projections are that additional funding will be needed no later than 2006. Without additional funding by the 2006 plan year serious changes to the funded level of coverage would be required.

The KTRS medical insurance plan is important to over 29,000 retired members currently with coverage and over 43,000 active members who qualify for the plan upon retirement. The Board of Trustees has reacted to the membership by identifying the medical issue as its top priority for the upcoming legislative session. The Trustees will be seeking a change in the funding formula needed to continue this plan at a meaningful and equitable level.

II. Cost-of-Living Adjustments

In addition to the permanent 1.5% Cost of Living Adjustment (COLA), KTRS requests funding in the budget for "ad hoc" COLA's to help members' retirement allowances keep pace with inflation. For the coming biennium, KTRS will request ad hoc COLA's of 0.8% for fiscal year 2004-2005, and 0.7% for fiscal year 2005-2006. If

continued on page 2 ...

approved by the Legislature, these ad hoc COLA's, added to the permanent 1.5% COLA, would provide members with a total COLA of 2.3% for fiscal year 2004-2005, and 2.2% for fiscal year 2005-2006. It is important to note that although KTRS always strives to provide the membership with COLA's that at least equal the rate of inflation, COLA's are dependent upon Legislative approval for inclusion in the state budget and consequently upon the availability of state funds to pay for them.

III. Other Measures

a. Modified Critical Shortage Program

The budget bill enacted during the 2003 General Session provided for a temporary retire-and-return-to-work program similar to the former critical shortage program. The budget bill's version of the critical shortage program is scheduled to sunset effective June 30, 2005. For the 2004 General Session, KTRS will propose replacing the budget bill program with a return-to-work program that is similar, except that it will no longer be necessary for the local school district to establish that a critical shortage exists. Furthermore, unlike the budget bill's version of the critical shortage program, the replacement program does not contain any sunset date upon which the program will automatically expire.

b. Alternative Break-in-Service Requirements

Retired members who wish to return to work in a KTRS-covered position are required to have separated from employment for twelve months if returning to work on a full-time basis for the same employer and for three months if returning to work full-time for a different employer or part-time for the same employer. For the 2004 General Session, alternative breaks-in-service will be proposed under which a retired member must have a minimum two-month break in service followed by a waiver of the member's retirement allowance for a period that would equal, when added to the two-month break in service, the number of months currently required for breaks-in-service. For example, a retired member would be able to return to work full-time for the same employer after a break of two months followed by a waiver of the member's retirement allowance for the ten months next succeeding the two-month break. Or, that same member could experience a six-month break in service followed by a waiver of the member's retirement allowance for the next succeeding six months. A retired member returning to work for the same employer on a part-time basis or a different employer on a full-time basis could do so after a break of two months followed by a waiver of the member's retirement allowance for the

next succeeding month.

c. Tax-Deferred Installment Payments

KTRS will seek a necessary statutory amendment to permit members to purchase service credit by installment payments on a tax-deferred basis. Currently, only lump sum purchases of service credit may be made on a tax-deferred basis by using tax-deferred transfers. If the necessary statutory amendment is made, KTRS would then be able to ask the Internal Revenue Service (IRS) for a private letter ruling approving tax-deferred installment payments. Subject to approval by the IRS, members would be able to purchase service credit on an installment basis through payroll deductions that are made before federal and state taxes are applied, a great savings for the member.

d. Out-of-State Teaching Service

Almost all service credit purchases must be made at full actuarial cost. Out-of-state teaching service is an exception. The current cost formula can result in widely varying costs for members purchasing this service depending on several variables. The issue of service credit purchases at less than full actuarial cost was recently a specific concern of the IRS when the retirement system was attempting to obtain a private letter ruling authorizing tax-deferred transfers from Kentucky Public Employees Deferred Compensation Authority to KTRS. The IRS did not approve tax-deferred transfers for purchases of service credit at less than full actuarial cost. Accordingly, members may not use tax-deferred funds to purchase out-of-state teaching service. Given the inequity of the current cost formula and with due regard to the concerns of the IRS, it will be proposed to the 2004 General Assembly that the cost of out-of-state teaching service, effective July 1, 2005, be set at full actuarial cost as are most other types of service credit purchases. The July 1, 2005 effective date would provide members with ample time to purchase out-of-state teaching service under the current cost formula if they wish to do so. If this proposal is enacted, members with out-of-state teaching service may wish to contact the Retirement System to obtain cost estimates under the current formula as well as under the full actuarial cost formula as the change would make the cost of out-of-state teaching service more expensive for some and less expensive for others.

e. Miscellaneous Proposals

There will be several miscellaneous proposals for the 2004 General Session in addition to the major items noted above. For example, it is proposed that purchases of non-current leaves of absence be expanded to permit

2004 Legislative Proposals continued on page 3 . . .

purchases for leaves of absence taken not only for reasons of personal health but also the health of a child, spouse or parent as described in the Family Medical Leave Act. Another proposal would increase some retired members' Daily Wage Thresholds by applying Cost of Living Adjustments to their last annual compensation whenever it was earned, not just from their retirement date forward. There will also be suggested statutory amendments to reflect changes in and compliance with the Internal Revenue Code as well as several technical amendments.

IMPORTANT NOTICE

This newsletter provides only a summary of some of the more significant proposals for the 2004 General Session and is intended for general informational purposes only. This summary does not contain all of the terms and detail of the actual proposals that will be submitted to the General Assembly. It must be emphasized that these are only proposals and are subject to legislative consideration and enactment. There is no guarantee that these proposals will be enacted as originally submitted or that they will be enacted at all. Therefore, no final retirement planning decisions should be made based purely upon these proposals as originally drafted. Any proposals that may eventually be enacted into law would not become effective until July 1, 2004 at the earliest.

System Does Not Own Mutual Funds

In recent weeks, members have contacted the Retirement System to inquire about the System's vulnerability from improperly managed mutual funds. The System does not own any mutual funds and has not been affected by improper mutual fund transactions. The System's portfolios are managed as separate funds that are not combined or commingled with the assets of other investors. The System retains control over all its assets.

The alleged, illegal conduct of mutual fund managers focuses on transactions of mutual fund units, not the stocks purchased by mutual funds. Since the System does not own mutual funds, it does not buy or sell mutual fund units. The alleged improper conduct included transacting mutual fund shares after stock markets had closed. In other instances, large movements of cash were permitted to enter and leave mutual funds when unit values were slightly different than the

aggregate underlying values of stocks owned by the funds. The net effect of the mutual fund investigations probably will be the imposition of tighter controls on the mutual fund industry and a reduction in mutual fund management fees.

Some members, who regularly invest in mutual funds, have noticed the relatively weak investment performance of broad market funds when they are compared to the Retirement System's stock portfolio. Without knowing the details of specific funds, the reasons for weaker mutual fund performance are subject to conjecture and certainly impossible to quantify. However, if the mutual fund trading improprieties are eliminated and management fees are limited, mutual fund investors should realize more competitive returns.

New Medicare Drug Bill

The President signed the Medicare Drug Bill on December 8th, 2003. With the information known at this time, it is the intent of the KTRS Board of Trustees to continue sponsoring its health plan that includes prescription drug coverage.

This means that our members will continue with the KTRS provided drug plan. The Medicare bill will not change the delivery of that plan so long as adequate funding is provided for the medical benefit. For the upcoming legislative sessions, KTRS will be seeking a change in the funding formula needed to continue the medical benefit at a meaningful and equitable level, which is important to both active and retired members. (See related article, page 1)

Medicare Rates for 2004

The Medicare Part A inpatient hospital deductible is \$876 compared to \$840 for 2003.

The Medicare Part B deductible remains the same amount at \$100 for 2004. The Medicare Part B monthly premium for 2004 is \$66.60 as compared to \$58.70 in 2003.

IMPORTANT TAX INFORMATION

State Tax Laws

Retirements prior to JANUARY 1, 1998, remain exempt from Kentucky taxes!

If your 1099R shows an amount in Box 12 (see explanation of form 1099R on page 5 of this newsletter), you have made contributions after 1997. Contributions after December 31, 1997 are subject to taxation by Kentucky. The taxable amount is calculated by dividing service credit earned after 1997 by the total service credit. This ratio (to 3 decimal places) is applied to the Federal Taxable amount (Box 2a). If the Federal Taxable amount is not determined, the ratio, expressed as a percentage, will be provided in Box 13. This does not necessarily mean that you will owe Kentucky taxes. If you earn more than \$39,400 from all retirement sources, you must complete schedule P. Schedule P, Part I outlines which portion is subject to tax and this is where box 12 or 13 must be considered. If you earn less than \$39,400 from all retirement sources, all retirement earnings are excludable from state taxes. The amount in Box 2a would be entered on Schedule M, Line 10.

Other Considerations . . .

In the event of a member's death, the final benefit payment must be adjusted; this usually results in an overpayment. If the benefit overpayment is not returned, the overpayment is subsequently deducted from the life insurance payment. If these events occur in different tax years, a corrected 1099R will be issued for the reduced amount for the preceding tax year. If the benefit payment is returned, a prorated amount will be issued to the estate. In this event, a 1099R will be issued for the current tax year (unless requested otherwise) for the amount of the additional payment.

The 1099R is subject to adjustments/corrections and the form will show the date of change on the bottom of each copy. Please use the latest dated copy for tax filing purposes. All corrections to the 1099R are reported to the IRS.

Phone numbers for your convenience:

KTRS 800-618-1687

KERS 502-564-4646

KERS Toll Free 800-928-4646

Deferred Compensation 502-573-7925

Toll Free 800-542-2667

Revenue Cabinet 502-564-4581

IRS 800-829-1040

How Does KTRS

***Compute the
State Taxable Amount?***

STEP 1

Years of service after January 1, 1998, divided by total years of service is the state taxable percentage.

STEP 2

The state taxable percentage times the federal taxable amount equals the state taxable amount.

**Retired Prior to
January 1, 1998**

Retired After January 1, 1998

***TOTAL FEDERAL RETIREMENT INCOME
LESS THAN \$39,400***

Retired After January 1, 1998

***TOTAL RETIREMENT INCOME
MORE THAN \$39,400***

KTRS benefits remain as STATE NONTAXABLE Income. (If you receive more than \$39,400 federal taxable retirement income - you are still required to prepare Schedule P.)

If federal taxable income from all sources is less than \$39,400, then all pension income is STATE NONTAXABLE Income.

State Income Tax Return. Your Form 1099R will have necessary information to prepare Schedule P.

2003 Tax Year Information

It's tax time again! KTRS will mail your 1099R tax form the last week in January 2004. If you do not receive your 1099R, please call us at 1-800-618-1687 and we will mail you a duplicate. The information center will confirm your name and address. The tax statement contains confidential information and can only be mailed to the member's address on record. For your protection, it is necessary that the member, Power of Attorney or beneficiary mail or fax (1-502-573-0254) KTRS a written request in order to send the 1099R to a different address. This special request will not change your permanent record unless you specifically request it to be changed. Please also visit our web site for additional information and forms. Change of address forms can be found on our web site at ktrs.ky.gov.

If your 1099R is returned due to an incorrect address, every reasonable attempt will be made to find a correct address. Once a correct address is determined, the 1099R and an address change form will be mailed to you. Your KTRS records will not be changed until the address change form is received back in our office.

**Below is an explanation of the
KTRS form 1099R :**

THE EASY EXPLANATION

BOX 1 (less) BOX 2a=BOX 5

BOX 1

Shows the total payments KTRS paid to you in 2003. This amount is reported on line 16a on IRS form 1040 (12a on IRS form 1040A).

BOX 2a

This is the portion of the total that is taxable. This amount is reported on line 16b on IRS form 1040 (12b on IRS form 1040A). If blank, box 2b 'Taxable Amount Not Determined' should be marked. In this case, please see your tax advisor.

BOX 5

Shows the nontaxable portion of the total. This amount is NOT reported anywhere on your tax return. It is an 'information only' box.

BOX 9b

This box will show an amount in the first year of retirement. This is the total amount contributed by the member that has been already taxed.

Form 1099-R 2003

OMB No. 1545-0119 Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
This information is being furnished to the Internal Revenue Service.

Payer's Federal Identification Number
61-0600439

**FEDERAL
COPY B - File with Recipient's
FEDERAL Tax Return**

Payer's Full Name and Address
**TEACHERS' RETIREMENT SYSTEM
OF THE STATE OF Kentucky**
479 Versailles Road, Frankfort, Kentucky 40601

1 Gross Distribution

BOX 1

2a Taxable Amount

BOX 2a

2b Taxable Amount
Not Determined ☐

Total
Distribution ☐

3 Amount in Box 2a Eligible for Capital
Gain Election

4 Federal Income Tax Withheld

5 Employee Contributions

BOX 5

BOXES 10-12
Shows the state tax information. KTRS does not withhold state taxes. Only the service earned after 1/1/98 is subject to **Kentucky** state taxation. Outside Kentucky, your resident state tax regulations apply.

6 Net unrealized appreciation in employer's securities

7 Distribution Code

IRA/SEP ☐

8 Other

9a Your Percentage of Total Distribution

9b Total Emp. Contribution

BOX 9b

10 State Tax Withheld

BOX 10

11 State/Payer's State Number
KY 077156

12 State Taxable Amount

BOX 12

State Percentage %

BOX 13

BOX 11



Annuity Payment Dates for 2004

January 29
February 26
March 29

April 28
May 27
June 28

July 29
August 27
September 28

October 28
November 24
December 29

PRSR STD
U.S. POSTAGE
PAID
Frankfort KY
Permit No. 730

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TEACHERS' RETIREMENT SYSTEM
OF THE STATE OF KENTUCKY
479 Versailles Road
Frankfort, Kentucky 40601-3800
Jan/Feb 04 \